

SUMMARY REPORT

HOUSING FINANCE TRAINING SEMINAR FOR PARTICIPANTS FROM THE
KINGDOM OF MOROCCO.

NOVEMBER 11 - 22, 1996

The Real Estate Center/International Housing Finance Program
The Wharton School, University of Pennsylvania

In Collaboration with:

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SEMINAR BACKGROUND AND OBJECTIVES

The Moroccan Government is currently preparing a major reform of its housing finance system. This reform aims at improving the delivery system, increasing the flow of resources for mortgage financing, better targeting government subsidies, and increasing the reach of the housing finance system to borrowers in the lower stratum of income. The preparations for the reform started in 1993, when USAID financed a comprehensive study of the housing finance situation in Morocco, and have continued up to the present. While the quality of the studies conducted and the various recommendations made to date have been appropriate to the existing conditions, most Moroccan decision makers felt that a specific training seminar on the topic, and secondary markets in particular, was needed to give them the necessary insight to tailor the anticipated reform to the specific needs and opportunities of Morocco. Indeed the concepts and techniques involved in secondary markets and mortgage backed securities are not sufficiently documented in French nor widely publicized. Technical Support Services, the institutional contractor for the Moroccan Urban and Environmental Services Project (Contract Number 608-0221-C-00-6000), formulated and assisted in the organization of a special focused training seminar for high level Moroccan decision makers. TSS subcontracted with The Wharton Real Estate Center to provide the in-depth information necessary to develop understanding of secondary markets and reach an informed decision on the best reform option for housing finance in their country.

SEMINAR DESIGN

The training seminar was designed jointly by a Moroccan representative, The Wharton Real Estate Center and TSS. The presence of the representative from Morocco was instrumental in clearly identifying the objectives, and subsequently, in organizing the preparation of relevant information on the Moroccan case study as well as in the selection and briefing of participants. The design of the seminar emphasized the need to prepare Moroccans for defining and implementing a major housing finance reform aimed at mobilizing increased financial resources at market conditions for housing mortgage finance. Accordingly the seminar was organized in two parts: (1) a first part focused on detailed explanation of the various tools and policies available to decision makers for shaping an efficient housing finance system (including subsidies), and (2) a second part concerned with the analysis of the Moroccan case study and discussion of appropriate design options with the faculty of the seminar. Chronologically, the two parts were intertwined as the Moroccan case study was presented very early during the seminar, revisited as appropriate during the various lectures, and discussed in detail at the end of the seminar.

Among other important design features, it is important to note the composition of the team of participants. USAID/Morocco drew on its long experience and extended network in the housing and financial sectors to select a relevant, motivated and cohesive team. From the initial planning phase of the seminar, it was decided to provide simultaneous translation. This made it possible to alleviate the language barrier and select participants on the basis of their role and their expected contribution to the design and implementation of the reform, rather than, as is often the case, on the basis of their fluency in English.

SEMINAR PREPARATION

Planning and preparations for the seminar were accomplished in a very short time frame. Actual preparations, including the design, started in mid September and the seminar was successfully delivered November 11 through 22, 1996. The short planning lead time, coupled with the late expansion of the program from 14 participants to 19, led to a few difficulties, particularly in getting required documentation to USAID/Morocco officials in charge of contracting procedures (the list of participants is attached in Annex 1). Despite the difficulties, all the authorizations were granted in time for the scheduled course dates. The Wharton Real Estate Center proved to be very accommodating, in addition to being an outstanding training institution. In fact it is the sole institution in the world having established experience in the delivery of this particular training subject matter to officials from developing countries.

The Ministry of Housing, ANHI and TSS Maroc played an important role in handling all international travel, briefing the participants before the seminar and clearly explaining the expected outcome. They also played a major role in gathering the information requested by Wharton and in preparing documents for the presentation of the Moroccan housing finance system. This information helped further customizing the seminar and targeting its content.

SEMINAR CONTENT

The detailed content of the seminar is attached in Annex II. In general, the attached program was followed and punctuality and regular attendance were the rule. Exceptions were kept to a minimum with one participant falling sick during one of the sessions and two others arriving late from Morocco because of a visa and compelling family problem.

All the lecturers possessed relevant practical experience at high levels, combined with exceptional academic and presentation skills. This gave them the mastery necessary to explain sophisticated topics in a such a way as participants with no particular background in the subject could understand, while more advanced or even specialized participants still find it interesting to follow and actually enhanced their understanding.

Participants were encouraged to interrupt the lecturer at any time to ask for explanations or clarifications. This allowed everyone to make sure that whatever had been presented was understood and that the foundations were solidly laid for more advanced concepts.

Summary of Topics presented by the principal lecturer:

The principal lecturer of the course literally walked the participants through the entire field of housing finance, starting with the definition and explanation of relevant financial terms and ending with clear explanations of the most sophisticated nuances and concepts of securities and secondary markets. Most importantly, during this process, the lecturer clearly spelled-out all the tools and policy instruments available for designing a housing finance system and tailoring it to the specific needs and available opportunities. Additionally, the lecture drew from a wealth of experiences in other countries to illustrate how these tools and policy options function and where they have been used both successfully and unsuccessfully.

The main conclusions drawn from the principal lecturer are summarized as follows:

a) Establishment of Secondary Markets: Contrary to some established views, secondary markets are not an exclusively American phenomena. They can be successfully implemented in any other country provided that their feasibility conditions are enforced. The issue is not whether secondary mortgage markets can be successfully created in developing countries, it is rather how big a leap such countries can make, or in other words, how long it will take them to bring their markets to the level of efficiency and sophistication of the market in the US. While these countries can not replicate overnight the American secondary mortgage market, they can take appropriate steps to move towards that direction and persevere by making improvements as they become feasible and are required.

The lecturer went through a detailed presentation of the history of mortgage financing in the US, and elsewhere, how and when the building blocks of today's secondary markets and their characteristics were shaped and the conditions that led to their introductions. This historical perspective was very useful in clearly explaining the options available to the decision makers for adapting the housing finance system in Morocco to the prevailing needs and opportunities. The challenge for the Moroccans is to determine, at this moment, what is the extent of change and specific steps they can introduce, as opposed to deciding to introduce a secondary market possessing all the desirable characteristics and efficiencies of systems that have developed over an extended period of time.

b) Credit Enhancement: The key principle that guided the design of the secondary mortgage markets in the US was to make mortgage instruments palatable to the various parties (i.e. borrowers, mortgage originators, mortgage processors and investors). Credit enhancement was among the most important tools utilized. This took several forms, the most important of which were deposit insurance and mortgage insurance (payment insurance on one hand and mortgage loan standardization on the other). The government

played a major role by issuing regulations responsive to the needs of the various parties and by acting through its specialized agencies to provide the various types of insurance (mentioned above) at times when these services were beyond the possibilities of private companies. It is crucial to understand that the government played the role of a facilitator, rather than that of a provider. It opted for putting in place the protections and risk mitigation instruments that the private sector needed in order to participate actively in the sector. Through time, the government slowly removed all legal barriers for private sector participation which allowed breaking institutional segmentation (as is the case now in Morocco) and geographical segmentation. It should be noted that housing finance in the US does not create any cost burden to the federal government, except as relates to the possibility of having to fulfill a guarantee for one of its agencies, which is an unlikely event. It should also be noted that private companies are increasingly interested in providing all types of insurance services and participating in this segment of the market.

c) Government Intervention: Government intervention is not an absolute necessity. A plan was presented to participants for securitization without government intervention. This plan requires the existence of portfolio lenders having an economic benefit to securitize on one hand as well as high rated banks for securitization, high rated banks for default and payment insurance, and high rated banks for liquidity. The plan also calls for credible trustees and credible local rating agencies. Given the size of the market in a country like Morocco, fees for these various intermediaries could significantly escalate the final costs to beneficiaries and thus further restrain affordability.

d) US Housing Finance Systems: In the US there are two types of housing finance systems. The US Government has played a major role in starting both systems:

- a system of portfolio lenders and a central credit agency (FHOA); and
- a system of temporary lenders, conduits and mortgage insurance (Fannie Mae, Freddie Mac and Ginnie Mae).

e) Mortgage Design: The design of a mortgage can be made to fit the particular needs of borrowers and investors. The seminar clearly illustrated the various mortgage design possibilities, from the old balloon mortgage to the latest double indexed mortgage, and explained their main features and how they can be used to make mortgage loans both affordable to borrowers and palatable to investors. This topic of discussion could have immediate application in Morocco, particularly for reforming the allocation of subsidies to beneficiaries. In addition to classroom discussions, a group of interested participants practiced computer assisted mortgage design and analysis using the Wharton facilities and software. All the participants received the above mentioned software as well as the accompanying instructions manual.

f) Allocation of Subsidies: In the US, the criteria for allocating subsidies is to maximize access to the mortgage finance system. If one classifies the population in three income groups: a first group that qualifies for one of the various mortgage loans; a second group that does not qualify at all; and a third group that normally does not qualify, but is very close, then subsidies should be used exclusively for this later group. By doing so the

government will get more people housed with the least budgetary burden. All lecturers clearly illustrated that subsidies create misallocation of resources and bring deficiencies in the system.

g) The Need for an Efficient Housing Sector: The principle lecturer stressed that while secondary mortgage markets can provide the necessary liquidity to the housing sector, this relationship is not only a one way relationship. An efficient housing sector is also a prerequisite for the emergence of secondary markets.

h) Mortgage Processing Fees: Technological advances and competition have lowered costs and made mortgages more affordable. In the US the processing fee for a mortgage loan is 25 base points. This fee covers the cost and provides a reasonable profit for the company processing loans. Processing costs are much higher in Morocco due to lack of competition, smaller loan amounts and low technology payment mechanisms. Lowering these costs through increased competition and introduction of relevant technologies should be one of the main thrusts of the reform effort.

i) Pathologies of Housing Finance Systems: The principal lecturer presented an interesting discussion on the pathologies of housing finance systems and their symptoms. The most common pathologies are financial repression and excessive market power (due to lack of competition and excessive bureaucracy). These pathologies and their symptoms are very illustrative and pertinent the design of the proposed Moroccan reform.

Summary of Topics presented by other lecturers:

Several other useful topics were presented by other lecturers. Some of these presentations were detailed discussions of topics covered by the principal lecturer. The presentations usually started with a brief conceptual framework followed by empirical or real experiences. These presentations are summarized below:

a) Inflation and Interest Rates: This presentation explained the determinants of interest rates in an economy. It explained the impacts of inflation, risks and management costs. During this presentation, the lecturer also explained the techniques used for pricing bonds and the variations in bond prices as they relate to changes in market interest rates. This part of the lecture familiarized the participants with the various desirable characteristics of bonds and how they can be used to make bonds attractive to different categories of potential investors.

b) Risk Management: The lecturer defined and explained the various risks faced by banking institutions as well as techniques for managing these risks and minimizing their negative impacts. A clear explanation was made of the notion of duration and the effects of various kinds of volatilities on both assets and liabilities of banking institutions. This session was very useful in understanding the issues faced by different types of bankers and their criteria for deciding on investments and borrowing. The lessons

learned during this presentation will be directly used for the design of palatable mortgages and mortgage backed securities.

c) **Mortgage Servicing:** During this session, the lecturer illustrated how technology and efficient management can sensibly lower loan processing costs. He also explained the difference in processing for portfolio lenders (the current situation in Morocco) and processing for secondary markets. The importance of lowering loan administration and processing costs was stressed throughout the seminar. The potential for processing cost reduction is very important in Morocco. The introduction of secondary markets will create a demand for loan servicing functions and will impose stricter processing standards. In the US, processing rights are valued and traded.

d) **Housing Policy Choices:** This was a short but important presentation on housing sector efficiency and housing subsidies. It highlighted the negative impacts of unnecessary regulations and badly designed housing subsidies. The presentation stressed the need to take into account actual demand for subsidies in order to alleviate the creation of excessive demand for otherwise unnecessary or undesirable products and services. Rather than subsidizing products across the board, the presentation advocated recognizing the need for a good or a service and helping households to acquire the good or service by paying the difference between what they could afford and a reasonable market value. This was illustrated by the US rental subsidy program. Another idea that emerged from this presentation was the ranking of subsidies on the basis of their relative contributions to achieving the higher objectives for which they are considered.

e) **Alternative Housing Finance Institutions For Low Income Households:** The lecturer confirmed through discussions of experiences in other countries the existence of a substantial unfulfilled demand for financial services, both saving and borrowing, among low income households. The lecturer drew from the experience of the Grameen Bank to illustrate how this bank adapts and prices its product to existing conditions and how it operates successfully with a very low percentage of default. The lecturer stressed again the negative impacts of such an unsatisfied demand, namely delayed consumption, long building periods and related inefficiencies in the use of existing infrastructure, and negative impacts on household productivity.

f) **Infrastructure Financing:** A whole day was set aside for infrastructure financing. This was very appropriate as the supply and pricing of infrastructure have major impacts on the housing sector. During this day, the lecturers presented both a conceptual framework and alternative institutional and financial mechanisms for producing and financing urban infrastructure. An emphasis was made on the increasing private sector role in infrastructure financing and delivery. The various forms of private interventions were presented and illustrated by real experiences from various countries. Cost recovery was stressed as being key to sustainability and efficiency.

g) **Secondary Mortgage Markets In Emerging Economies:** This presentation was one of the most impressive and useful presentations of the seminar and was clearly

tailored to the needs of participants who will be directly involved in the preparation of future reform, but who are not necessarily specialized in banking or finance. During this presentation, the lecturer gave an overview of past experiences of attempting to introduce secondary mortgage markets in the developing world. He clearly defined the main features of these efforts and the reasons for their eventual success or failure. Through these examples, it was possible for the participants to gain further insights into the feasibility conditions of secondary markets. This presentation was also instrumental in treating the case of the very poor whose needs can not be readily accommodated through a market oriented housing finance system nor exclusively satisfied through access to property.

The lecturer further presented an effective housing finance system as being one of seven pillars of an efficient housing sector. He ended his presentation with a summary of current worldwide trends in the structuring of housing finance systems. In most countries, one can distinguish three strata of incomes each with specific needs and characteristics:

- The first stratum (including the eighth income percentile and above): This stratum of the population can be served by the financial system at market conditions and contribute savings to it.
- The second stratum (comprised of the third to eighth percentiles): This stratum can also be served by the financial sector at market conditions but needs personalized assistance in the form of housing acquisition grants. This stratum also has some saving potential.
- The third stratum (comprised of the first to third income percentiles) : This stratum can not be served by the financial system at all. The current tendency for this stratum is subsidized rental housing.

The current trend is to tailor both shelter products and housing finance products to the specific needs and characteristics of each of these three income strata. From an institutional point of view, this translates into creating two different housing finance systems and two separate but complementary sets of institutions to administer them.

The first financing system is geared towards the needs of the lower income strata and is essentially a subsidy system administered by a public institution performing two essential functions: (1) promoting low income rental housing and administering a rental housing subsidy program; and (2) administering a subsidy program aimed at increasing the access of the upper layers of low income households to the market oriented housing finance system.

The second financing system is a mortgage finance system catering to the first two income strata. Households in the first stratum and the upper layers of the second stratum can normally access the system without any financial assistance. Some households in the lower layers of the second stratum require financial assistance to qualify for loans. The current tendency in these mortgage finance systems is to have a two-tiered system. The first tier consists of general purpose primary banks and other financial institution acting

as both temporary and portfolio mortgage lenders (originators). The second tier is composed of refinancing institution(s) tapping resources from institutional investors, local and foreign financial markets, and international donors to provide the mortgage lenders with necessary liquidity. Diversified mortgage designs and other more sophisticated financial products and services are being introduced at a pace that is commensurate with the learning speed of both borrowers and lenders and the improvement of financial engineering skills and expertise.

The need for refinancing is already very clear in Morocco, not only for current housing production level, but even more so given the desired increase in the production levels, particularly for low income households.

Summary of Moroccan Case Study Session:

The seminar concluded with a discussion of the Moroccan case study with a panel of faculty members, including the principal lecturer. This session provided a platform for the various participants to ask questions related to their particular professional areas of interest and expertise. Most of the questions centered around the details of the actual functioning of secondary markets and the applicability of the concepts presented to the Moroccan situation. Both faculty and participants were extremely satisfied with this concluding session. It clearly demonstrated the extent to which the participant improved their knowledge of secondary market issues and instruments as well as the measure of housing finance reform reasonably feasible in Morocco today. Arguments were made for avoiding institutional segmentation and excessive market power to allow cost reductions through increased competition, for creating refinancing institution(s) and for persevering to create increasingly sophisticated instruments in harmony with the increased level of learning, financial engineering skills, and improved technologies. Finally, the introduction of clear rules and transparent procedures allowing the free play of market forces were supported, and the case was made for a shift towards transforming the role of the government from a provider to a facilitator.

CONCLUSION AND PROPOSED FOLLOW-UP ACTIVITIES

Both the participants and organizers evidenced a high degree of satisfaction with the seminar. The participants acquired an enhanced understanding of housing finance in general and secondary mortgage markets in particular. The organizers found it extremely rewarding to work with a highly motivated group of senior decision makers intent on gathering as much insight as possible for direct application to the design of an imminent reform. The follow-up activities, described below, will provide a mechanism to fully assess the impact of the seminar and to verify the hypothesis that led to its organization (i.e. its potential contribution to facilitating the design of the intended reform of the housing finance system in Morocco and to accelerating its implementation).

Areas where improvements to the seminar could have been made include:

- providing more time for the preparation and planning of the seminar;
- improving translation services; and
- extending the reach of the seminar to additional relevant decision makers in the areas of finance, capital markets, retirement and other social funds, insurance companies, and banks.

Follow-Up Activities

Discussions concerning the follow-up activities began at Wharton while the seminar was still in progress. Three activities have been programmed as follows:

a) Organization of a two-day workshop: The purpose of this workshop, scheduled to take place January 7 & 9, 1997, is to further explore the ideas and insights gained during the seminar in relation to work done so far, through a organized “brainstorming” session. The anticipated output of this session will be a comprehensive design of a reform strategy that has the ownership and support of all key contributors. The workshop will regroup all the participants to the Wharton seminar and will be facilitated by TSS. During the second day of the workshop, a brief presentation of the work, the reform strategy, and the action program for its preparation and implementation will be made to a larger audience.

b) Organization of a national conference on housing finance: The purpose of this conference is to sensitize Moroccan decision makers to the need to reform the housing finance sector and to gain a wide acceptance of the reform strategy and content. During this conference, presentations will be made by eminent foreign specialists and high-level Moroccan officials on the trends of housing finance in Morocco, and in other relevant countries, followed by an official announcement of the strategy adopted for Morocco and the justifications for it. The conference, presided over by the Minister of Housing, is planned to last two days.

c) Ministry of Housing launch of reform: Following the national conference, the Ministry of Housing will immediately launch the required implementation studies and start the procedure for approvals and authorizations of the main components of the reform. It should be noted that some new secondary market activities are scheduled to start in January when Credit Immobilier et Hotelier (CIH) plans to issue its first Mortgage Backed Security for 300 Million Dirhams.

These three activities are viewed as the necessary initial steps to implementation of effective reform. The two-day workshop will solidify ideas and lessons from the Wharton seminar and further develop the necessary ownership and support for the planned reform amongst the key decision makers. The national conference will further communicate the needs for reform to a broader base of constituents, and the leadership of Ministry of Housing will be the key factor to implementation.